SC93162

IN THE SUPREME COURT OF MISSOURI

MINACT, INC.,

Respondent (Petitioner below),

vs.

DIRECTOR OF REVENUE,

Appellant (Respondent below).

From the Administrative Hearing Commission of Missouri
The Honorable Sreenivasa Rao Dandamudi, Commissioner

BRIEF OF APPELLANT

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES

OTHER AUTHORITIES

JURISDICTIONAL STATEMENT

This case came before the Administrative Hearing Commission on a complaint filed by Minact, Inc., appealing the Director of Revenue's decision regarding 2007 income tax liability. The question posed to the Commission was whether income in Minact's "rabbi trust" – used to attract and retain key employees – constitutes "business income" pursuant to § 32.200, RSMo (2013 Cum. Supp.),[1/] The Commission concluded that the income is not "business income," and the Director appeals.

The issues before the Court in this matter involve the construction of § 32.200, a revenue law of the State of Missouri. Therefore, this Court has exclusive jurisdiction over this matter pursuant to Article V, § 3 of the Missouri Constitution.

1/ All references to the Missouri Revised Statutes are to the 2013 Cumulative Supplement unless otherwise specified.

STATEMENT OF FACTS

Minact, Inc., is a Mississippi corporation domiciled and headquartered in Jackson, Mississippi. (LF 1, 85). Minact's business primarily focuses on managing Job Corps Centers in several states, including Missouri, as a contractor for the U.S. Department of Labor. (LF 1, 86). Minact has two centers in Missouri, one in Excelsior Springs and the other in St. Louis. (LF 1, 86).

A. Minact Created a "Rabbi Trust" to Attract and Retain Key Employees.

On August 2, 1988, Minact established an Executive Deferred Compensation Plan (the "Plan") for the purpose of providing deferred compensation for a group of key managerial and executive employees. (LF 88). The Plan gives certain employees an opportunity to defer percentages of their future salaries and bonuses, coupled with matching employer payments. (LF 5, 88). The Plan is a type of non-qualified deferred compensation arrangement that is recognized under § 409A of the Internal Revenue Code of 1986, as amended. (LF 88). The Plan was subsequently amended to allow for the use of an irrevocable "rabbi trust" (the "Trust"). (LF 89).

Minact established the Trust as part of its executive compensation plan for the purpose of funding long-term liabilities that the company will owe to

certain of its key executives under the Plan. (LF 5, 89). Rabbi trusts are generally recognized under federal income tax law. (LF 89). A rabbi trust is a grantor trust that is established by an employer (the "grantor") to fund a federally recognized "unfunded" nonqualified deferred compensation plan.[2/] (LF 89). Rabbi trusts derive their name from a federal letter ruling in which the IRS approved the use of a trust to provide nonqualified deferred compensation benefits for the rabbis of a Jewish congregation. (LF 89); Priv. Ltr. Rul. 81-13-107 (Dec. 31, 1980).

Minact created its Plan and the Trust specifically "to attract and reward qualified staff ['basically senior staff']" beyond the means available at the time. (Devore Depo. SLF18:1-3). Minact wanted "to be able to recruit them from other companies, and to be competitive in doing that we wanted to offer as attractive a benefit plan as we could." (Devore Depo. SLF18:9-11; *see also id.* SLF23:17-20 noting that management believed the Plan and Trust

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[2/] The Plan, and the Trust that "funds" the Plan, are considered "unfunded" because the Plan is not governed by ERISA and the beneficiaries are not guaranteed to receive any Plan benefits until they actually receive them. (LF 89). The Trust is used to give employees limited security that the funds necessary to pay their benefits will actually be there when the employees leave the company. (LF 89).

would be "helpful in terms of attracting or retaining employees"). This was the "primary motivation" for creating the Plan and Trust. (Devore Depo. SLF18:4). And when asked if offering the Plan and Trust was "successful for that purpose," Minact's Executive Vice President for Operations stated "Yes, I do." (Devore Depo. SLF23:21-23).

B. Creating a "Rabbi Trust" and Paying Taxes.

In order to qualify as a rabbi trust, an employer must be the grantor of the trust and must report the trust's earnings as income on the employer's federal income tax returns. (LF 89). The employer may not deduct contributions to the trust, but it may take compensation deductions when benefits are paid to plan participants. (LF 89). The trust may be either revocable or irrevocable (although the trust must become irrevocable if the employer is sold)[3/] and the employees may not have vested rights in any of the trust's assets until they are actually entitled to receive benefits under the nonqualified deferred compensation plan. (LF 89-90).

The trustee must be a third party (in this case Regions Bank) that is granted corporate powers under state law but must be independent from the employer. (LF 90). In order to qualify as a rabbi trust, the trust's assets must be subject to the claims of the employer's general creditors (*i.e.*, creditors

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[3/] Minact's Trust is irrevocable. (LF 90).

must be able to attach the trust's assets in the event of the employer's bankruptcy or insolvency). (LF 90).

Because a rabbi trust is a grantor trust under federal tax law, *see* Treas. Reg. § 1.677(a)-1(d), Minact is required to report the Trust's earnings as taxable income. (LF 90). And because the Plan is a "non-qualified plan" under Internal Revenue Code § 409A, Minact is not entitled to deduct the contributions that it makes to the Trust to fund Plan benefits. (LF 90). Minact is only entitled to deduct benefits that the Trust actually pays to the Plan beneficiaries. Similarly, Minact's employees, who are beneficiaries under the Plan, do not recognize income when Minact makes the contributions to the Plan or when Trust income is allocated to their accounts. (LF 90). The Plan beneficiaries recognize income only when they actually receive Plan benefits that are paid to them by the Trust, upon either a hardship distribution or their termination from employment. (LF 90).

Minact made three contributions to its Trust, totaling $519,061.82 for the fiscal year 10/1/07 through 9/30/08, and identified its obligations to the Trust as "Long Term Liabilities" on the accompanying balance sheet. (LF 91). Under the terms of the Trust agreement, Minact must hold the principal of the Trust, and any earnings thereon, separate and apart from other funds of the company and must use such principal and earnings "exclusively for the uses and purposes of Plan Participants, and general creditors…Any assets

held by the Trust will be subject to the claims of the Company's general creditors under federal and state law in the event of Insolvency, as defined in Section 3(a) herein." (LF 91-92). The Trustee is precluded from reinvesting the Trust's earnings into Minact. (LF 92).

Once Minact contributes funds to the Trust, except in the case of insolvency or termination of the Plan and Trust, Minact has no power to direct the Trustee to return or otherwise divert any Trust assets before all payment of benefits that are required under the Plan have been made. (LF 92). The contributions and any income that the Trust earns from those funds may only be used by the Trust to pay Trust benefits. (LF 92). Minact may, however, in its sole discretion, substitute assets of equal fair market value for any asset held by the Trust in a like-kind exchange. (LF 92). The Trustee may also loan Minact the proceeds of any borrowing against an insurance policy held as an asset of the Trust. (LF 92).

If Minact becomes insolvent or bankrupt, its creditors can access the Trust funds, but such action on the part of creditors in the event of bankruptcy or insolvency would not diminish the rights that participating eligible employees have to pursue their Plan benefits as general creditors with respect to the benefits due to them under the Plan. (LF 92). The Trust may not terminate until the date on which employees participating in the Plan (and their beneficiaries) are no longer entitled to benefits under the

terms of the Plan. (LF 92). Upon termination of the Trust, any remaining assets (if any) are returned to Minact. (LF 92).

Minact originally formed the Plan and the Trust in order to provide supplemental retirement benefits for key employees. (LF 93). The Plan is designed to be a "non-qualified" extension of the existing 401(k) Plan. (LF 93). And according to the plain language of the Trust, the "Trust Agreement may be amended by written instrument executed by Trustee and Company [*i.e.* Minact]." (LF 42, 179).

Each year, the Board of Directors of Minact designates the key managerial and executive employees who are eligible to participate in the Plan, and therefore the Trust. (LF 93). These include all of Minact's employees who have reached the "qualified" salary limits under its 410(k) Plan, including at least one key employee that lives in Missouri. (LF 93, 392). The Trust's benefits approximate the same benefits that are available under Minact's 401(k) plan, but only apply to the excess salary and bonus (if applicable) of each employee who has exceeded the 401(k) salary/bonus limitations. (LF 93).

C. Minact Treats Its Trust Income as Non-Business Income.

On March 13, 2009, Minact filed its Missouri corporate income tax return for the corporation income tax period beginning October 1, 2007, and ending September 30, 2008 ("tax period 2007"). (LF 12, 86). As part of the income tax computation Minact allocated $667,773 as non-business income on the Schedule MO-MS. (LF 12). This income was identified as follows:

Accrued investment income	$5,886
Ordinary gains	$0
Other income – MS Spec	$212,378
Other interest	$351,672
S/T capital gain/loss	-$143,303
L/T capital gain/loss	$241,140
Total	$667,773

(LF 12).

Following a review of Minact's corporate income tax return for tax period 2007, the Director of Revenue issued a "Notice of Adjustment Corporate Income/Franchise Tax Form 5003" to Minact that stated, in relevant part, that Minact's "nonbusiness income all sources reported as

$667,773.00 was approved as $0.00." (LF 86). The Director then applied additional payments that had been received from Minact, and after applying these additional payments, Minact no longer had a balance due for the tax period 2007. (LF 86-87).

Minact responded to this Notice in a letter, objecting to the disallowance of its treatment of the $667,773.00 as non-business income. (LF 86). Minact filed a "Notice of Written Protest," in which it protested, in part, the Director's adjustment that disallowed the claimed non-business income. (LF 86). Minact conceded that $212,378 of the $667,773 should be treated as business income. (LF 87). Yet, Minact maintained that the remaining $455,395 – identified as interest income and capital gains earned by its rabbi trust established to compensate key employees – should be treated as non-business income. (LF 87). Minact, instead, reported and allocated 100% of the Trust's income to Mississippi, its state of domicile, and paid Mississippi income taxes on that income. (LF 95).

The Director held an informal hearing on the merits of Minact's protest, and Minact submitted additional information in a follow-up letter. (LF 87). The Director ultimately issued a Final Decision, disallowing the treatment of the $455,395.00 of income generated by the rabbi trust as "non-business income." (LF 87). Minact then filed its Complaint with the Administrative Hearing Commission. (LF 87). The Commission, after a short

analysis, determined that the income generated by the "Rabbi Trust" is non-business income. (LF 381-85).

POINT RELIED ON

The Commission Erred in Holding that Minact, Inc. is Not Required to Apportion Its Income From a Rabbi Trust for Tax Purposes, Because the Income is "Business Income" That Must be Apportioned, in That it is Used to Attract and Retain Key Employees – an Integral Part of the Operations of Any Business.

ABB C-E Nuclear Power Inc. v. Dir. of Revenue, 215 S.W.3d 85 (Mo. banc 2007)

Hoechst Celanese Corp. v. Franchise Tax Bd., 106 Cal.Rptr.2d 548 (2001)

§ 32.200, RSMo (2013 Cum. Supp.)

12 CSR 10-2.075

Va. Tax Comm'r Ruling 03-60

HELLERSTEIN & HELLERSTEIN, *State Taxation*, ¶ 9.13[1][b], S9-21 (3d Ed. 2013 Cum. Supp.)

SUMMARY OF THE ARGUMENT

Attracting and retaining key employees is unquestionably an important business purpose. *See, e.g., Estate of True v. C.I.R.*, 2001 WL 761280, 26 (U.S. Tax Ct. 2001). No one disputes that. And it is *the* reason that Minact, Inc. invested in a Trust to provide additional retirement benefits for its key employees, including employees in Missouri. Minact's Trust earned significant income for the tax period 2007, income that Minact paid taxes on, but not in Missouri. Instead, all of the taxes on the income in the Trust were paid to its state of domicile, Mississippi, because Minact believed that the income from the Trust was non-business income. That is not the case.

Under the controlling functional test in Missouri, income is "business income" subject to apportionment for purposes of taxes if the acquisition, management, and disposition of the property, constitute integral parts of the taxpayer's regular trade or business. *ABB C-E Nuclear Power Inc. v. Dir. of Revenue*, 215 S.W.3d 85, 87 (Mo. banc 2007). Here, Minact is using its Trust, and the income from the Trust, as an incentive to attract and retain key employees, including at least one key employee in Missouri. Indeed, Minact's Executive Vice President for Operations testified that the "primary motivation" for creating the Trust was "to be able to recruit [key employees] from other companies, and to be competitive in doing that we wanted to offer

as attractive a benefit plan as we could." (Devore Depo. SLF18:4, 9-11). The Trust has been successful in this regard. (Devore Depo. SLF23:21-23).

Although the issue is one of first impression in Missouri, legal authorities have concluded that attracting and retaining key employees with an incentive – like an additional retirement plan – is an integral part of a taxpayer's regular trade or business. *See Hoechst Celanese Corp. v. Franchise Tax Bd.*, 106 Cal.Rptr.2d 548 (2001); HELLERSTEIN & HELLERSTEIN, *State Taxation*, ¶ 9.13[1][b], S9-21 (3d Ed. 2013 Cum. Supp.) (Appdx. A42-44). The Virginia Tax Commissioner, in fact, has concluded that income from a "rabbi trust," used to attract and retain key employees, is business income subject to apportionment for purposes of taxes. *See* Va. Tax Comm'r Ruling 03-60, www.policylibrary.tax.virginia.gov/OTP/Policy.nsf/ (Appdx. A37-40). Thus, the income from the Trust in this case should be treated as business income, and apportioned and taxed accordingly.

ARGUMENT

Standard of Review

A decision of the Administrative Hearing Commission ("Commission") will be affirmed only if: "(1) it is authorized by law; (2) it is supported by competent and substantial evidence on the whole record; (3) mandatory procedural safeguards are not violated; and (4) it is not clearly contrary to the reasonable expectations of the General Assembly." *Brinker Mo., Inc. v. Dir. of Revenue*, 319 S.W.3d 433, 435-36 (Mo. banc 2010); *see Luhr Bros., Inc. v. Dir. of Revenue*, 780 S.W.2d 55, 57 (Mo. banc 1989) (requiring that the decision be "authorized by law and supported by competent and substantial evidence upon the whole record"); § 621.193 (establishing review standards).

When the Commission has interpreted the law or the application of facts to law, the review is *de novo*. *State Bd. of Registration for the Healing Arts v. McDonagh*, 123 S.W.3d 146, 152 (Mo. banc 2003); *Zip Mail Servs., Inc. v. Dir. of Revenue*, 16 S.W.3d 588, 590 (Mo. banc 2000). The Commission's factual determinations "are upheld if supported by 'substantial evidence upon the whole record.' " *Concord Publ'g House, Inc. v. Dir. of Revenue*, 916 S.W.2d 186, 189 (Mo. banc 1996) (quoting *L & R Egg Co. v. Dir. of Revenue*, 796 S.W.2d 624, 625 (Mo. banc 1990)).

Here, the Commission's decision is not supported by the law, and should, therefore, be reversed in favor of the Director.

The Commission Erred in Holding that Minact, Inc. is Not Required to Apportion Its Income From a Rabbi Trust for Tax Purposes, Because the Income is "Business Income" That Must be Apportioned, in That it is Used to Attract and Retain Key Employees – an Integral Part of the Operations of Any Business.

The treatment of income for a multistate taxpayer such as Minact, and the apportionment of that income for tax purposes, is nothing new to the states. In Missouri, for example, the apportionment of income is determined by statute – the "Multistate Tax Compact" – codified at § 32.200. This law, along with Missouri's regulations and relevant legal authorities, all provide that the income at issue in this case is business income, and therefore subject to apportionment in Missouri.

A. Businesses Such as Minact are Subject to Apportionment of Income in Missouri for Tax Purposes.

Missouri can tax the income of a nondomiciliary business like Minact, when the out of state activities are related in some "concrete way" to Missouri activities. "[T]he functional meaning of this requirement is that there be some sharing or exchange of value not capable of precise identification, beyond the mere flow of funds arising out of a passive investment or a

distinct business operation, which renders formula apportionment a reasonable method of taxation." *Luhr Bros., Inc. v. Dir. of Revenue,* 780 S.W.2d 55, 59 (Mo. banc 1989) (citing *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 166 (1983)).

There are two requirements that must be met to establish a tax nexus: (1) there must be a connection between the taxpayer and Missouri, and (2) the out of state income that is subject to taxation must bear a sufficient relationship through the taxpayer to the taxing state. *Amway Corp., Inc. v. Dir. of Revenue*, 794 S.W.2d 666, 671 (Mo. banc 1990); *James v. Int'l Tel. & Tel. Corp.*, 654 S.W.2d 865, 868 (Mo. banc 1983). "The first nexus requirement is met if the taxpayer avails itself of the substantial privilege of doing business in the state and the second is met if the intrastate and extrastate activities form part of a unitary business." *Amway Corp.*, 794 S.W.2d at 672.

In this case, there is no dispute that Minact is subject to apportionment of income for purposes of taxes in Missouri. Indeed, Minact already pays taxes in Missouri arising from the operation of its business in Missouri and its business income. Minact has offices and employees in Missouri that are part of its overall business and therefore has availed itself of the substantial privilege of doing business in the state, and its intrastate and extrastate activities form part of a unitary business.

B. Minact's Business Income, Including Income in its Trust, is Subject to Apportionment in Missouri for Purposes of Taxes.

Not only is Minact subject, generally, to the apportionment of its income among the several states for purposes of taxes, but the income at issue in this case is also subject to apportionment among the states. After all, income in a rabbi trust is unquestionably subject to taxes. HELLERSTEIN & HELLERSTEIN, *State Taxation*, ¶ 9.13[1][b], S9-21 (3d Ed. 2013 Cum. Supp.) (noting it is "undisputed that the income from the rabbi trust was taxable under the grantor trust rules"). Even Minact does not dispute this point, having paid 100% of its taxes to Mississippi – its state of domicile – on the income in its Trust.

The only question in this case is whether Minact must apportion its Trust income to all states in which it does business, for purposes of taxes, or on an allocated basis only to its state of domicile. To make this determination, Minact elected the Multistate Tax Compact three-factor method of apportionment set forth in § 32.200, in which income is allocated or apportioned based on whether it is business or non-business income.

Business income is apportioned among all the states where the taxpayer conducts business. Non-business income, in contrast, is generally allocated only to the commercial domicile of the taxpayer. Here, Minact

considered income in its Trust as non-business income and allocated it all to Mississippi, its state of domicile. Section 32.200, Art. IV.1(1) defines business income as, "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business." This statutory definition, and its corresponding tests, make clear that income in a rabbi trust is business income.

1. The functional test for business income is met because Minact uses its Trust to attract and retain key employees.

In Missouri, like other states, courts have recognized two tests that may be used to determine whether income constitutes apportionable business income – a transactional test and a functional test. *ABB C-E Nuclear Power Inc. v. Dir. of Revenue*, 215 S.W.3d 85 (Mo. banc 2007). The transactional test determines whether the gain at issue is attributable to a type of business transaction in which the taxpayer regularly engages. *Id.* at 87. The functional test determines whether the acquisition, management and disposition of the property, constitute integral parts of the taxpayer's regular trade or business. *Id.* If the income meets either the transactional or the functional test, it is

apportionable business income. The income in this case meets the functional test.

Under the functional test, income is business income "if the acquisition, management, and disposition of the [income-producing] property constitute integral parts of the taxpayer's regular trade or business operations." *Hoechst Celanese Corp. v. Franchise Tax Bd.*, 106 Cal.Rptr.2d 548 (2001). An item of income would satisfy this functional test if the taxpayer's acquisition, control and use of the property "contribute[s] materially to the taxpayer's production of business income." *Id.* at 568.

Minact identifies its primary trade or business as the management of Job Corps Centers that are located throughout the country, including two in Missouri. In 1988, Minact established a nonqualified deferred compensation plan (the "Plan") to provide additional benefits to its high-level employees. In 1994, it created a rabbi trust (the "Trust") to enable it to set aside and invest earnings to be used to fund future retirement benefit payouts as required by the Plan. Any income received by the Trust on investments is required to be accumulated and reinvested by the trustee. In the event that Minact becomes insolvent, all assets of the Trust are subject to Minact's creditors. Similarly, if the Trust is terminated, all assets remaining in the Trust are returned to Minact. The express purpose for creating the Trust was to attract and retain key employees.

The ability to attract and retain key employees has been universally considered an important business purpose. Even U.S. Tax Court decisions conclude that efforts to attract and retain key employees constitute "bona fide business purposes." *Estate of True v. C.I.R.*, 2001 WL 761280, 26 (U.S. Tax Ct. 2001); *see also Grant-Jacoby, Inc. v. Comm'r of Internal Revenue*, 73 T.C. 700, 715 (U.S. Tax Ct. 1980) (concluding that a plan "served substantial business purposes" because it was "adopted to improve the morale of key employees, to retain them, and to recruit other key employees").

Efforts to attract and retain key employees is accomplished in a variety of ways. Through offering bonuses, *see, e.g., Philip Morris, Inc. v. Dir. of Revenue*, 760 S.W.2d 888, 889 (Mo. banc 1988), health benefit plans, *see, e.g., Robin v. Blue Cross Hosp. Serv., Inc.*, 637 S.W.2d 695, 697 (Mo. banc 1982), stock options, *see, e.g., Ralston Purina Co. v. Leggett*, 23 S.W.3d 697, 699 (Mo. App. E.D. 2000), and profit sharing, *see, e.g., First Bank of Commerce v. Labor and Indus. Relations Comm'n of Mo.*, 612 S.W.2d 39, 46 (Mo. App. W.D. 1981), to name a few. In this case, Minact accomplishes its unquestioned business purpose of attracting and retaining key employees by offering a Trust to its key employees. This is an integral part of the business.

Minact argued before the Commission that the income generated from its Trust investments is non-business income because it was not earned in the regular course of its trade or business. But this looks at the entirely

wrong object of the investment. The investment and the income generated is intended to attract and retain key employees – a bona fide business purpose – not to merely increase the bottom line of the business through a passive investment.

Minact also points to its inability to control or manage the trust assets and the fact that it "set apart" funds related to its retirement plan from its normal operating funds. Minact cited below *Siegel-Robert, Inc. v. Comm'r of Revenue*, Docket No. 00-3763-III (Tenn. Chancery Ct., 2006) (*Siegel-Robert I*), *Siegel-Robert, Inc. v. Johnson*, 2009 WL 3486625 (Tenn. App. 2009) (*Siegel-Robert II*) and *Sperry & Hutchinson Co. v. Dep't of Revenue*, 527 P.2d 729 (Or. 1974) (LF 340-51), as support for the classification of the Trust income as non-business income. But these cases, and Minact's reliance on them, misses the point again.

In *Siegel-Robert I* and *II*, the court held that the corporation's interest earned on investments in U.S. Treasury securities was non-business income because it did not arise from transactions and activities in its regular course of business. But these investments were not being used to attract or retain key employees in the company's regular course of business. In *Sperry*, the Oregon Supreme Court held that interest income from a long-term investment was non-business income because neither the capital nor the income itself was derived from the taxpayer's regular business. Again, the

investment income did not serve to attract or retain key employees. Neither of these cases are persuasive because the courts also did not analyze the business income issue under the functional test. And in both cases, the income did not satisfy a bona fide business purpose other than to increase the bottom line through a passive investment.

In contrast, the California Supreme Court's decision in *Hoechst Celanese Corp. v. Franchise Tax Board*, 106 Cal. Rptr.2d 548 (2001) is compelling. In *Hoechst*, a corporate taxpayer created a qualified retirement plan for its employees and maintained a trust that funded the plan. The taxpayer made contributions to the trust, to be invested by a third-party trustee, but did not hold legal title to these assets and could not use the trust assets to fund any of its regular business activities. The assets reverted back to the taxpayer only upon the termination of the retirement plan and the satisfaction of all benefits owed to plan participants. After years of wise investments, some of the trust assets were no longer needed to fund the retirement plan obligations. The taxpayer recaptured these surplus assets by terminating the original trust and placed the reverted assets in its general operating fund. On its California tax return, the taxpayer treated the reverted income as non-business income, which was challenged by the state.

The California Supreme Court found that the reverted income was business income under the functional test incorporated in the definition of

"business income" in the Multistate Tax Compact. Under the functional test, income is business income "if the acquisition, management, and disposition of the [income-producing] property constitute integral parts of the taxpayer's regular trade or business operations." As the court held, an item of income would satisfy this functional test if the taxpayer's acquisition, control and use of the property "contribute[s] materially to the taxpayer's production of business income." *Id.* at 568.

The Court explained how the reverted assets met this test:

> Hoechst created the income-producing property—the pension plan and trust—*in order to retain its current employees and to attract new employees*. Hoechst had "broad authority to amend the plan" and retained an interest in any surplus pension assets. It funded the plan with its business income and used these contributions to reduce its tax liability. Hoechst exercised control over the plan and its assets through various committees composed of its officers and employees.
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> * * *
>
> Because the pension plan assets contributed materially to Hoechst's *production of business income*

> *via their effect on Hoechst's labor force*, the "acquisition, management and disposition of" these assets "constitute integral parts of" Hoechst's "business operations."

Id. at 536 (emphasis added). In this case, just as in *Hoechst*, Minact created its Plan and funded it with a Trust to help retain and attract key employees. These "key employees" are critical to the management of Minact, including the management of the Job Corps Centers in Missouri.

The Commission below attempted to distinguish *Hoechst* in two ways. First, the Commission incorrectly argued that Minact had a "total lack of control over the operation of the Rabbi Trust," arguing that in *Hoechst*, the company had power to amend or discointinue the pension plan and to appoint and replace the trustees at any time. (LF 397). In fact, the Plan and Trust documents in this case expressly provide that Minact's "Board may amend or terminate the Plan . . . at any time," and can also remove the trustee for the Trust. (LF 147, 178).

The Commission's second attempt to distinguish *Hoechst* is equally unavailing. According to the Commission, *Hoechst* is distinguishable because the employer "retained the power to administer the pension plans and to determine the right of any person to receive benefits." (LF 397). Once again, the Commission mistates the evidence in this case. The Plan authorizes

Minact to determine who can participate in the Plan, and therefore the Trust. (LF 93). And the Plan specifically provides that Minact "shall have full power to administer the Plan in all of its details." (LF 144).

In addition, Minact may also take compensation deductions when benefits are paid to Plan participants, and any excess funds revert to Minact upon termination of the Plan and Trust. The retirement Plan and Trust arrangement that Minact created is comparable to the pension plan in *Hoechst*. The Trust contributed materially to Minact's production of business income, as it has attracted and retained key employees whose knowledge and experience helped Minact succeed. Therefore, Minact's "acquisition, management and disposition of" the Trust was an integral part of its business.

Under an identical set of circumstances – a "rabbi trust" – the Virginia Tax Commission concluded that "[b]y providing for additional retirement compensation of its corporate officers, the taxpayer is providing an incentive to attract and retain top executives. Inasmuch as attracting and retaining quality corporate officers is an integral part of the operations of any business, the establishment and resulting income of the rabbi trust serves an operational function." Va. Tax Comm'r Ruling 03-60. As such, the Virginia Tax Commission concluded that the income from a rabbi trust should be apportioned. The Commission below did not even attempt to distinguish this

decision, noting only that the Virginia Commissioner "did not provide any facts regarding the rabbi trust other than the fact of its creation and that its purpose was 'to provide additional retirement compensation for the officers of the corporation.' " (LF 398).

The Commission's attempts to distinguish both the decision in *Hoechst* and the ruling from the Virginia Tax Commission fail. Indeed, the leading tax treatise has analyzed these same authorities as well as the Commission's decision below and concluded that "in our view, the case for apportionment among all the states in which the taxpayer does business rather than allocation to the taxpayer's commercial domicile seems more persuasive for the reasons stated by the Virginia Tax Commissioner." HELLERSTEIN & HELLERSTEIN, *State Taxation*, ¶9.13[1][b], S9-21 (3d Ed., 2013 Cum. Supp.).

2. Missouri's regulation confirms that the functional test is met in this case.

In addition to the statute, and relevant authority, the applicable Missouri regulation –12 CSR 10-2.075 – also sets forth the methods to be used in apportioning income to Missouri under § 32.200. 12 CSR 10-2.075(4) provides:

> In general all transactions and activities of the taxpayer which are dependent upon or contribute to the operation of the taxpayer's economic enterprise as

> a whole constitute taxpayer's trade or business and will be transactions and activity arising in the regular course of, and will constitute integral parts of, a trade or business. In essence, all income which arises from the conduct of trade or business operations of a taxpayer is business income. For purposes of administration of section 32.200 (Article IV), RSMo, the income of the taxpayer is business income unless clearly classifiable as nonbusiness income. Nonbusiness income means all income other than business income.

Once again, the income of the Plan and Trust in this case is integral to Minact's operation as a business under the regulation. Otherwise, Minact would not have created the Plan and Trust, or invested significant amounts of the company's earnings in an effort to attract and retain key employees.

As set forth in the authorities above, efforts to attract and retain employees contributes to the taxpayer's economic enterprise. Missouri's regulation recognizes this very point and confirms that the associated income is subject to apportionment for purposes of taxes among the many states in which Minact does business instead of allocation to the one state in which it is legally domiciled.

CONCLUSION

For the foregoing reasons, the Administrative Hearing Commission's decision should be reversed and Minact's income in its rabbi trust should be apportioned in Missouri, for purposes of taxes, just as the Director concluded.

Respectfully submitted,

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CERTIFICATE OF SERVICE AND COMPLIANCE

I hereby certify that a true and correct copy of the foregoing was filed and served via Missouri CaseNet on August 22, 2013, to:

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The undersigned further certifies that the foregoing brief complies with the limitations contained in Rule No. 84.06(b) and that the brief contains 5,986 words.

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